

COVID-19 hurts cigarette performance; Valuations undemanding

ITC's Q4FY20 print was largely in line with our estimates on key metrics, but positively surprised us on the Gross Margins front. We note, Cigarette volumes likely declined by 9-10% vs our/street estimate of 4%/7-8% decline in Q4. Standalone Net Sales stood at Rs 11,300 Cr down by 6.3% YoY (our estimate Rs. 11,765cr), dragged largely by 7%/12 YoY decline in its core Cigarettes Revenue/EBIT impacted by supply disruption and increased cigarette prices (hike in duty in Budget) affecting volumes. Owing to subdued cigarette EBIT performance, overall EBIT excluding Other Income de-grew 11% YoY at Rs 3,771 Crs with EBIT margin contracting by 225bps YoY to 33.4%. PAT in Q4FY20 was 9% higher YoY ahead of our expectations aided by lower tax rates at 15.8% vs 29.7% in Q4FY19 (Rs 340cr credit due to remeasurments of deferred tax expenses). FMCG segment remained resilient with quicker resumption of operations (c.80-85% utilization levels) given the essential nature of its portfolio across FMCG categories. However, Hotels business continues to be impacted given discretionary nature and uncertainty on resumption of travel and tourism activities in the near to medium term. As per the new dividend payout policy for FY20, ITC declared dividend of Rs 10.15/share (~80% payout) vs Rs 5.75 in FY19. Although, our Revenue/PAT estimates undergo revision for FY21/22 by 11%/19% and 12%/14% resp. we believe a faster than expected recovery in Cigarette biz owing to possible market share gains (peer operations hit by COVID) and resilience of its packaged foods business. **Maintain BUY with marginal revision in our TP to Rs. 230/share (Rs. 237 earlier) given undemanding valuations, +5% dividend yield and cash rich (Rs. 300bn FY20) balance sheet.**

Key takeaways

- Cigarette biz growth subdued Q4 performance:** Cigarette biz Revenue/EBIT declined 7%/12% respectively largely driven by a 9-10% decline in volumes. Cigarette volumes were impacted owing to price hikes, nationwide lockdown from mid-March, weak rural demand and wholesale channel affected by tight market liquidity. Management indicated all factories currently are operational with progressive normalization witnessed in sales and distribution ops. In its efforts to maintain leadership amid challenging market conditions, ITC introduced new variants and offered aggressive promotional offers to its trade channels for new launches in KSFT/RSFT segment.
- FMCG biz was on track to deliver double digit performance but for pandemic outbreak:** ITC's FMCG (others) segment Revenue de-grew 3% which was better than some of the FMCG peers while, EBIT of Rs 147 Crs grew 12% YoY aided by operating . We believe, revenue degrowth of 3% YoY better compared to some of its FMCG peers given resilience of its diversified product portfolio which includes staples like atta, biscuits, noodles, juices, soaps, handwashes/sanitizers etc. Whereas EBIT Margins at 5% expanded by 63bps/137bps YoY/QoQ resp driven by increased profitability from the business despite investments in brands and high gestation costs of new products.

Our View:

Clearly, Q1FY21 performance will be severely impacted owing to COVID-19 led disruptions. Resultantly, our FY21E/22E Revenue/PAT estimates see a downward revision of 11%/19% and 12%/14% resp. However, progressive normalization of ops across segments, share gain possibilities in core cigarette biz, quicker recovery in FMCG sales given increased in-home consumption and consumers' preference towards trusted brands could support an earlier than expected recovery in earnings in the near term. At CMP stock trades at 15.5x FY22E EPS providing enough valuation comfort and high dividend yield +5%. Maintain BUY with marginal revision in TP to Rs. 230/share (Rs. 237 earlier). Key risks to our call: 1) SUUTI stake sale overhang, 2) uncertainty on lockdown relaxations, 3) aggressive competition, 4) adverse government regulations

Key Financials (Standalone)

(Rs. Cr)	FY19	FY20	FY21E	FY22E
Net Sales	48,353	49,404	47,132	51,081
EBITDA	18,406	19,260	16,595	19,257
Net Profit	12,824	15,717	13,296	15,569
EPS (Rs.)	10.5	12.8	10.8	12.7
PER (x)	18.7	15.3	18.1	15.5
EV/EBITDA (x)	12.8	12.3	14.4	12.4
P/BV (x)	4.1	4.0	4.0	4.0
ROE (%)	21.7	26.3	21.9	25.5

Source: Company, Axis Research

(CMP as of June 26, 2020)	
CMP (Rs)	196
Upside /Downside (%)	17%
High/Low (Rs)	283/135
Market cap (Cr)	239821
Avg. daily vol. (6m) Shrs.	1,35,14,914
No. of shares (Cr)	1,229.2

Shareholding (%)

	Mar-20	Dec-19	Sep-19
Promoter	0.0	0.0	0.0
FIs	14.6	15.2	15.6
MFs / UTI	9.9	9.6	9.5
Banks / FIs	8.0	8.0	8.1
Others	67.4	67.2	66.9

Financial & Valuations

Y/E Mar (Rs. bn)	2020	2021E	2022E
Net Sales	494.0	471.3	510.8
EBITDA	192.6	165.9	192.6
Net Profit	157.2	133.0	155.7
EPS (Rs.)	12.8	10.8	12.7
PER (x)	15.3	18.1	15.5
EV/EBITDA (x)	12.3	14.4	12.4
P/BV (x)	4.0	4.0	4.0
ROE (%)	26.3	21.9	25.5

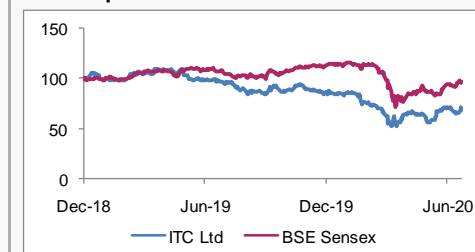
Change in Estimates (%)

Y/E Mar	FY21E	FY22E
Sales	0.0	2.6
EBITDA	11.8	5.8
PAT	15.8	6.5

Axis vs Consensus

EPS Estimates	2021E	2022E
Axis	10.8	12.7
Consensus	11.9	13.7
Mean Consensus TP (12M)	232	

Relative performance



Source: Capitaline, Axis Securities

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Key takeaways (Cont'd)

- **Hotels business:** Hotels business revenues which were growing strong in 9MFY20 and Jan-Feb declined sharply by 8% YoY at Rs 466 Crs majorly impacted by the lockdown owing to pandemic outbreak impacting travel and tourism leading to sudden fall in tourists. EBIT degrew by more than 50% with severe 825bps YoY contraction in EBIT Margin to 9%. Given the uncertainty on containment of coronavirus the segment will continue to be impacted in FY21E.
- **Agriculture, Paper & Paperboard remain laggards in Q4:** Revenue/EBIT of the Agri business reported degrowth of 10%/17% YoY at Rs 1,887 Crs/ Rs 123 Crs respectively impacted by subdued demand for leaf tobacco in international markets, steep INR depreciation and adverse mix. Paper & Paperboard Revenues/EBIT were lower by 6%/5% YoY owing to sluggish demand in key end-user industries.

Q4FY20 Key Financials

	Q4FY20	Q4FY20E Axis Estm	Var (%)	Q4FY19	% Change (Y-o-Y)	Q3FY20	% Change (Q-o-Q)
Volume Growth	-8.0	-4.0	-400bps	7.0	-1500bps	2.0	-1000bps
Net Sales	11,300	11,765	(4.0)	12,064	(6.33)	11,912	(5.14)
Gross Profit	7,233	7,277	(0.6)	7,449	(2.9)	7,366	(1.8)
Gross Margin (%)	64.0	61.9	216 bps	61.7	227 bps	6.2	5783 bps
Staff costs	667			760	(12.3)	669	(0.4)
Other operating expenses	2,523			2,259	11.7	2,185	15.5
EBITDA	4,164	4,509	(8.0)	4,572	(8.9)	4,613	(9.7)
<i>EBITDA margin (%)</i>	<i>36.8</i>	<i>38.3</i>	<i>-148 bps</i>	<i>37.9</i>	<i>-105 bps</i>	<i>38.7</i>	<i>-188 bps</i>
Other Income	756			740	2.1	984	(23.2)
Interest	15			8	90.3	12	18.4
Depreciation	393			350	12.1	416	(5.7)
PBT	4,512			4,954	(8.9)	5,168	(12.7)
Tax	715			1,472	(51.4)	894	(20.0)
Tax rate (%)	15.8			29.7	-1387 bps	17.3	-145 bps
Adj. PAT	3,797	3,635	4.5	3,482	9.1	4,142	(8.3)
Adj. EPS	3.1	3.0	4.5	2.9	7.2	3.4	(8.3)

Source: Company; Axis Securities

Q4FY20 Segmental Performance

	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)
Segment gross Sales Standalone					
Cigarette	5,131	5,486	-6.5%	5,311	-3.4%
Other FMCG	3,184	3,274	-2.8%	3,312	-3.9%
Hotel	466	510	-8.6%	552	-15.7%
AgriBusiness	1,887	2,101	-10.2%	2,095	-9.9%
Paper Board	1,459	1,537	-5.1%	1,555	-6.2%
% Revenue Contribution					
Cigarette	42.3%	42.5%	-19bps	41.4%	90bps
Other FMCG	26.3%	25.4%	89bps	25.8%	43bps
Hotel	3.8%	3.9%	-11bps	4.3%	-47bps
Agri Business	15.6%	16.3%	-71bps	16.3%	-77bps
Paper Board	12.0%	11.9%	12bps	12.1%	-10bps
Segment EBIT					
Cigarette	3,403	3,856	-11.7%	3,756	-9.4%
Other FMCG	147	130	12.6%	108	36.5%
Hotel	43	89	-52.0%	87	-51.2%
Agri Business	123	147	-16.4%	213	-42.3%
Paper Board	286	301	-4.9%	334	-14.5%
Segment EBIT Margin %					
Cigarette	66.3%	70.3%	-396bps	70.7%	-439bps
Other FMCG	4.6%	4.0%	63bps	3.2%	137bps
Hotel	9.1%	17.4%	-825bps	15.8%	-667bps
Agri Business	6.5%	7.0%	-49bps	10.2%	-367bps
Paper Board	19.6%	19.5%	4bps	21.5%	-189bps

Other Key Takeaways

- 1) **Cigarettes:** Standalone Net Sales de-grew 7% YoY to Rs 5,130Cr driven by -9% volume de-growth (sharply lower than our estimates 4-5% volume de-growth) and price/mix led growth of 1.5% in our view. Volume growth was impacted owing to overall weakness in demand especially in rural markets and wholesale channel along with tight market liquidity conditions and increasing salience of illicit trade especially at the premium end. Cigarette EBIT de-grew 12% while EBIT Margins contracted by 396bps to 66.3% impacted by supply disruption, steep increase of ~13% in taxes announced in Budget 2020 and COVID-19 led operational disruption from mid-March 2020.

- 2) **FMCG:** Management indicated that prior to outbreak of pandemic, FMCG business was on track to deliver double digit growth for FY20 in the backdrop of a sharp deceleration witnessed in FMCG industry growth rates dragged by rural demand growing at 0.8x of urban markets in FY20 compared to 1.4x in FY19. Management indicated that within FMCG, categories with higher rural salience remains the most impacted. In the premium categories ITC continued to consolidate its leadership position especially in premium biscuits, confectionary, dairy, juices and body wash; Atta continues to do well with its market share fortified across geographies. *Going forward, a good kharif crop, government measures to uplift economic growth are expected to uplift growth rates. Further, staples, noodles, biscuits, dairy etc witnessed healthy demand during lockdown indicating consumers' preference for trusted brands. However, demand for discretionary categories continues to remain soft and will be impacted from a near term perspective.*
 - ✓ **New product launches:** During the lockdown period, which started from March 22, ITC launched two products under the Savlon brand -- hand sanitiser and soap, germ protection wipes, sanitizer pouch at 50p driving penetration of the brand and surface disinfectant spray. It also launched vegetable and fruit spray Nim Wash to capitalize on the growing opportunity in the health and hygiene space. Under fruit juice brand B Natural, ITC launched variants like Veggies, Mixed Fruit+, Orange+, Mango Bitz and Nagpur Orange while, under the Aashirvad brand it launched Aashirvad Svasti Lassi.
 - ✓ **E-commerce tie up in a bid to reach consumers:** To ensure direct reach to consumers and ensure increased availability of its products in e-commerce platforms ITC tier up with leader food and e-commerce partners like Dominos, Dunzo, Swiggy, Zomato, Amway etc.
 - ✓ **Inorganic acquisition in Spices segment:** ITC acquired 100% of equity share capital of Ms. Sunrise Foods Pvt. Ltd for an estimated value of Rs. 2,000cr (4x EV/Sales; 30x EV/EBITDA basis FY19 numbers) as per some media reports. Sunrise Foods is engaged in the business of spices manufacturing under brand 'Sunrise' with leadership position in the Eastern markets in India.
 - ✓ **Education & Stationary products segment performance marred in Q4:** This segment reported strong growth until Feb 2020, was severely impacted in the peak month of March 2020 due to closure of educational institutions and deferment of new academic year across the country pursuant to nationwide lockdown and continued deferment of opening schools and educational institutions.

- 3) **Other businesses – subdued performance to continue:**
 - ✓ **Hotels:** Segment recorded strong double digit growth in Jan and Feb, however, COVID-19 disruptions (closures) led to 9% decline in Q4FY20. For 9MFY20 segment Revenue/EBIT was up 19%/29% respectively. For FY21, we expect the Hotels segment to be severely impacted owing to travel restrictions that could hurt business/leisure travel.
 - ✓ **Agri business:** During Q4FY20, Revenue/EBIT performance continued to be impacted owing to lower leaf tobacco exports on account of subdued demand in international markets. However, passing of the APMC amendments act by the Government augurs well for the division's growth over the medium to long term perspective as ITC can then leverage its e-choupal network and bring in sourcing efficiencies and thus cost rationalization.
 - ✓ **Paper & Paper board:** Q4FY20 saw adverse impact on business owing to supply chain disruption following the outbreak of the pandemic towards the year. Although, capacity addition in the Value Added Paperboards segment bolstered Revenue, slowdown in customer off-take due to sluggish demand in end-user industries weighed on the performance of the packaging segment.

- 4) **Re-measurement of DTA:** ITC re-measured its deferred Tax Liabilities (net) as at 31st March, 2019 and the estimate of tax expense for theyear ended 31st March, 2020 in the quarter ended September 30, 2019. The resultant favourable impact of Rs 1020 Crs has been recognised over the three quarters of the financial year commencing from quarter ended 30th September, 2019. Consequently, tax expense for the quarter ended 31st March, 2020 includes a credit of Rs 340cr.
- 5) **Revised Dividend Policy:** During Feb 2020, ITC revised its dividend policy to now pay out 80-85% of its profitability as dividend as comparnd to earlier 65-70% dividend payout. In accordance with revised dividend policy, for FY20 ITC declared dividend of Rs 10.15/share which is higher than Rs 5.75 per share dividend in FY19.

Change in Estimates

(Rs Cr)

	Revised		Old		%Change	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Revenue	47,132	51,081	52925	57975	(10.9)	(11.9)
EBITDA	16,595	19,257	20523	22562	(19.1)	(14.6)
EBITDA Margin %	35.2	37.7	38.8	38.9	-357 bps	-122 bps
PAT	13,296	15,569	16433	18127	(19.1)	(14.1)
EPS	10.8	12.7	13.4	14.7	(19.3)	(13.8)

Source: Company, Axis Research

Valuation & Outlook

We maintain BUY on ITC with marginal revision in our TP to Rs. 230/share (Rs. 237 earlier) as we value it at 18x FY22E EPS despite downward revision in our Revenue/EBITDA estimates for FY21E/22E by 11%/19% and 12%/14% respectively to factor in near term growth challenges. Our call is based on the expectation that ITC's valuations are most attractive in the FMCG pack at 15.5x FY22E EPS, 2) increased dividend payout (+5% dividend yield going forward), 3) cash rich balance sheet (~Rs. 300bn FY20 cash) could lead it to undertake value accretive acquisition in its quest for growth especially in the FMCG business and 4) faster than expected recovery in its core cigarette business aided by market share gains as plants of its competitors continue to remain shut given its presence in containment zones. Key risks to our call are: 1) SUUTI stake sale overhang, 2) adverse government regulation on sin goods/ compensation cess, 3) quicker resumption of competition operations and increased sale of illicit cigarette trade, 4) uncertainty on lockdown relaxations with pockets across geographies undergoing lockdown and relaxation depending on the rise in COVID-19 active cases.

Financials

Profit & Loss

(Rs Cr)

Y/E March	FY19	FY20E	FY21E	FY22E
Net sales	48,353	49,404	47,132	51,081
Growth, %	11.3	2.2	-4.6	8.4
Other income	0	0	0	0
Total income	48,353	49,404	47,132	51,081
Raw material expenses	-17,420	-17,345	-17,119	-17,945
Employee expenses	-4,178	-4,296	-4,254	-4,466
Other Operating expenses	-8,348	-8,503	-9,165	-9,413
EBITDA (Core)	18,406	19,260	16,595	19,257
Growth, %	11.7	4.6	-13.8	16.0
Margin, %	38.1	39.0	35.2	37.7
Depreciation	-1,397	-1,645	-1,674	-1,644
EBIT	17,010	17,615	14,921	17,613
Growth, %	11.6	3.6	-15.3	18.0
Margin, %	35.2	35.7	31.7	34.5
Interest paid	-45	-55	-56	-57
Other Non-Operating Income	2,174	2,598	2,910	3,259
Pre-tax profit	19,138	20,158	17,775	20,815
Tax provided	-6,314	-4,442	-4,479	-5,245
Profit after tax	12,824	15,717	13,296	15,569
Net Profit	12,824	15,717	13,296	15,569
Growth, %	15.8	22.6	-15.4	17.1
Net Profit (adjusted)	12,835	15,584	13,296	15,569
Unadj. shares (cr)	1,226	1,229	1,229	1,229

Source: Company, Axis Securities

Balance Sheet

(Rs Cr)

As at 31 st Mar	FY19	FY20E	FY21E	FY22E
Cash & bank	4,152	3,110	2,769	1,389
Debtors	4,035	2,301	2,195	2,379
Inventory	7,860	7,128	7,035	7,375
Loans & advances	7,197	5,181	5,181	5,181
Total current assets	23,152	17,629	17,089	16,232
Investments	25,043	25,043	25,043	25,043
Gross fixed assets	23,888	26,888	29,888	32,888
Less: Depreciation	-4,716	-6,361	-8,035	-9,679
Add: Capital WIP	4,136	3,730	3,730	3,730
Net fixed assets	23,308	24,257	25,583	26,939
Total assets	71,504	66,929	67,715	68,214
Current liabilities	9,990	4,736	4,675	4,899
Provisions	51	51	51	51
Total current liabilities	10,042	4,788	4,726	4,950
Non-current liabilities	2,304	2,304	2,304	2,304
Total liabilities	12,346	7,092	7,030	7,254
Paid-up capital	1,226	1,229	1,229	1,229
Reserves & surplus	57,915	58,590	59,438	59,713
Shareholders' equity	59,158	59,837	60,685	60,960
Total equity & liabilities	71,504	66,929	67,715	68,214

Source: Company, Axis Securities

Cash Flow

(Rs Cr)

Y/E March	FY19	FY20E	FY21E	FY22E
Pre-tax profit	19,138	20,158	17,775	20,815
Depreciation	1,397	1,645	1,674	1,644
Chg in working capital	-1,056	-956	137	-299
Total tax paid	-6,185	-4,442	-4,479	-5,245
Cash flow from operating activities	13,175	17,539	15,224	16,914
Capital expenditure	-2,875	-2,593	-3,000	-3,000
Chg in investments	-2,991	0	0	0
Cash flow from investing activities	-5,866	-2,593	-3,000	-3,000
Free cash flow	7,309	14,945	12,224	13,914
Equity raised/(repaid)	6,648	679	848	275
Dividend (incl. tax)	-8,498	-15,041	-12,448	-15,295
Cash flow from financing activities	4,412	-11,497	-10,310	-15,020
Net chg in cash	11,721	3,448	1,915	-1,106

Source: Company, Axis Securities

Ratio Analysis

(%)

Y/E Mar	FY19	FY20E	FY21E	FY22E
Per Share data				
EPS (INR)	10.5	12.8	10.8	12.7
Growth, %	13.6	22.2	(15.4)	17.1
Book NAV/share (INR)	48.3	48.7	49.4	49.6
FDEPS (INR)	10.5	12.8	10.8	12.7
CEPS (INR)	11.6	14.1	12.2	14.0
DPS (INR)	5.8	10.2	8.4	10.5
Return ratios				
Return on equity (%)	21.7	26.3	21.9	25.5
Return on capital employed (%)	22.1	25.5	21.3	24.7
Turnover ratios				
Asset turnover (x)	1.6	1.5	1.4	1.4
Sales/Total assets (x)	0.7	0.7	0.7	0.8
Sales/Net FA (x)	2.1	2.1	1.9	1.9
Working capital days	68.0	72.3	74.7	71.1
Liquidity ratios				
Current ratio (x)	2.3	3.7	3.7	3.3
Quick ratio (x)	1.5	2.2	2.2	1.8
Dividend cover (x)	1.8	1.3	1.3	1.2
Valuation				
PER (x)	18.7	15.3	18.1	15.5
Price/Book (x)	4.1	4.0	4.0	4.0
Yield (%)	2.9	5.2	4.3	5.4
EV/Net sales (x)	4.9	4.8	5.1	4.7
EV/EBITDA (x)	12.8	12.3	14.4	12.4
EV/EBIT (x)	13.9	13.5	16.0	13.6

Source: Company, Axis Securities

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BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning valuation and recommendation
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